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IN THE

Supreme Court of the United States

OCTOBER TERM, 1954

No. 15

AUSTIN F. McFEE, *Petitioner*

v.

UNITED STATES OF AMERICA, *Respondent*

MOTION FOR LEAVE TO FILE FURTHER SUPPLEMENT TO PETITION FOR WRIT OF CERTIORARI

The petitioner moves for leave to file the attached Further Supplement to Petition for Writ of Certiorari; and in support thereof states:

The opinions of this Court handed down December 6, 1954, in the cases of *Marion L. Holland, et al.* v. *United States of America* (No. 37), *David Friedberg* v. *United States of America* (No. 18), *Daniel Smith* v. *United States of America* (No. 52) and *United States of America* v. *Edward B. Calderon* (No. 25) have resolved several uncertainties in the law and have clarified the nature of, and controlling standards applicable to the establishment of taxable income by the use of the "net worth" method.

These are circumstances of substantial and controlling effect which have intervened since the Petition for Writ of Certiorari in this cause was filed on October 23, 1953.

WHEREFORE, petitioner prays that the foregoing motion be granted.

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Counsel for Petitioner

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IN THE

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No. 15

AUSTIN F. McFEE, *Petitioner*

v.

UNITED STATES OF AMERICA, *Respondent*

FURTHER SUPPLEMENT TO PETITION FOR WRIT OF CERTIORARI

This case illustrates some of the dangers or pitfalls in the use of the net worth method of establishing taxable income which were enumerated in the opinion of Mr. Justice Clark, speaking for this Court, handed down December 6, 1954, in the case of *Holland* v. *United States of America* (No. 37).

1. The Government Did Not Establish a Likely Source of the Alleged Net Worth Increase.

In the case of *Holland* v. *United States, supra,* this Court stated:

> (1) "There is great danger that the jury will assume that once the Government has established the figures in its net worth computations, the crime of tax

> evasion automatically follows. The possibility of this increases where the jury, without guarding instructions, is allowed to take into the jury room the various charts summarizing the computations; * * * "

In the present case, the Government investigating agents, Olsen and Rice, after a rather limited investigation of leads which would have explained the source of petitioner's "unexplained" expenditures made net worth computations for each of the two prosecution period years (1945 and 1946) and presented four charts (Exhibits 47, 48, 49 and 50—R. 241, 246) which were handed to the jury (R. 242) and which undoubtedly were available to the jury during its deliberations. A copy of the net worth statements contained in Exhibits 49 and 50 is set forth in the appendix hereto.

Thus we have in this case, a setting which may well be fraught with the "great danger" alluded to by this Court.

In *Holland* v. *United States, supra,* this Court also stated (p. 15 of the printed opinion):

> "Increases in net worth, standing alone, cannot be assumed to be attributable to currently taxable income. But proof of a likely source, from which the jury could reasonably find that the net worth increases sprang is sufficient."

The source of the alleged unreported income in the present case as set forth in the Bill of Particulars was "limited to those sources reported by the defendant for income tax purposes for said years" 1945 and 1946 (R. 17). Those sources were (1) North Idaho Sales Company a sole proprietorship during 1945 and 1946 which was engaged in the business of operating vending machines, and amusement machines, and other coin operated machines in various locations in northern Idaho and (2) the operation of three taverns for the first half of the year 1945, and thereafter one tavern, known as the Foresters Club, at

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Lewiston, Idaho. There were one or two other ventures but they were loss ventures, and were not of any importance as a possible source of income. The source actually suspected by the Government was from the coin operated machines operated by North Idaho Sales Company.

But the evidence, adduced by the Government not only failed to show that petitioner received as much as one penny of unreported income from any source whatever, but it failed to show that petitioner *had access to* any known source of unreported income.

Petitioner did not personally operate his business. All cash or other receipts from the taverns were handled and recorded by employees. All receipts were rung up on the cash register and the register tapes were balanced against cash daily. The cash was deposited in bank and the records were sent in daily to the central office where they were again checked and balanced and were entered in the permanent records (R. 301, 325). And as far as the coin operated machines were concerned the evidence affirmatively shows, without conflict, that all collections were made and recorded by employees, and deposited in bank by employees and that those machines were locked and that petitioner did not have a key thereto.

There was absolutely no evidence, direct or indirect, which showed or tended to show that petitioner received, or ever had the opportunity to receive, any amount of unreported or unrecorded income either from the designated sources, or the suspected source or any other source during the prosecution period.

On the contrary one of the Government's own witnesses, Emasio, testified that there was no way in which petitioner could have withdrawn funds from his business without such withdrawals being recorded in his drawing account. (R. 70-71). This testimony strongly tends to negative such a source.

Furthermore the Government agent, Olsen, specifically stated that the source of the money used for the so-called

unexplained expenditures was unknown (R. 242, 244); and that if petitioner had had cash on hand prior to the prosecution period, the expenditures could have come from that source (R. 254).

The Government agents concluded that the unreported net worth increase represented currently taxable income merely because they did not find out where the money came from (R. 250-255). The Government definitely did not establish any likely source of the alleged net worth increases.

In this respect the present case differs materially from the case of *Holland* v. *United States, supra,* as well as the other three net worth cases referred to therein, also decided on the same day. In each of those cases a "likely source" of unreported income was shown.

Inasmuch as there was a failure to establish a "likely source" of the alleged unreported income, the inference that the "unexplained" net worth increases were in fact current taxable income, is far less justified in the present case than in the four net worth cases referred to above. Therefore, unless there is adequate evidence elsewhere in the record tending to support the inference that the net worth increase represented current taxable income, the alleged increases in net worth, standing alone "cannot be assumed to be attributable to currently taxable income."

This brings us, then, to inquire into the nature and extent of the examination or search which led up to the making of the net worth statements, the failure, if such there was, to explore pertinent or vital "leads" as to the source of funds used for the "unexplained" expenditures, whether petitioner's records and books of account were adequate to account for such expenditures, and whether the petitioner was placed in the position of having to assume the burden of proof in order to disprove or account for the apparent net worth increase.

2. The Government Agents Failed to Track Down an Important and Relevant Lead as to the Existence of a Substantial Asset Referred to as an Item of $114,000.

In approaching this case it may be appropriate to point out that this is not a case where there were any secret bank accounts, or safe deposit boxes, nor was there any use of fictitious names or other attempted concealments, nor were there incomplete or inaccurate books of account, or other subterfuges or devices usually employed by persons attempting to evade taxes. Moreover, the petitioner in this case unquestionably can, if he be required to assume the burden of proof, establish not only that *all* of the unreported portion of his alleged net worth increase for the year 1945 was not taxable income at all, but he can also establish the exact source thereof. He can also establish that a large portion ($39,101.69) of the alleged increase in net worth for the year 1946, was not taxable income, and that in its subsequent settlement of petitioner's civil tax liability for the year 1946, the Government conceded that the alleged unexplained net worth increase of $70,769.76 relied upon by the Government in the criminal case for the year 1946 involved herein (R. 245) was over stated by at least $39,000, leaving only $31,769.76 to be "explained" for that year. There is more than a reasonable probability that petitioner owed no additional tax whatever for the year 1945, and there is grave doubt as to his guilt with respect to the year 1946.

As stated by this Court in *Holland* v. *United States, supra,* "an essential condition in cases of this type is the establishment, with reasonable certainty, of an opening net worth * * * " (p. 9 of printed opinion).

In this case the Government agents failed to track down an important and relevant lead as to the existence, shortly prior to the prosecution period, of an item of $114,000 which would have completely exonerated petitioner as to the year 1945, and in a large measure as to the

year 1946.* Petitioner was thus forced by the risk of an adverse verdict to come forward with proof to substantiate this lead (R. 307). Cf. *Holland* v. *United States* at p. 13 of the printed opinion. Petitioner's proofs in an effort to assume this unexpected burden of proof were incomplete because petitioner did not have adequate time, between the receipt of the bill of particulars and the trial of the case to locate and produce the necessary witnesses. The bookkeeper who kept the accounts reflecting the exact status of this fund (and its availability as a cash asset not included in the Government's opening net worth statement) was finally located in New York but was not immediately available as a witness (see Affidavit of Austin F. McFee attached to Motion for Leave to File Supplement to Petition for Writ of Certiorari, filed November 15, 1953). Another witness who had knowledge of substantial cash on hand was located at Lincoln, Nebraska (R. 395). And other witnesses who could have established the authenticity of brokerage records indicating other assets not included in the opening net worth statement, could not be located in the limited time (R. 371 and 375 et seq.) Petitioner himself was not called as a witness to substantiate the account apparently because his trial attorney chose not to do so inasmuch as the record showed he had been convicted and fined for an O.P.A. offense (R. 108).**

The government agents were most diligent in ferreting out the fact that petitioner had paid this fine out of cash from "unexplained" sources (R. 108, 115, 139). The fine grew out of the same transaction that involved the $114,000

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* The Government agents interviewed Helen Knoerr the bookkeeper who kept the books of account covering in minute detail this $114,000 item. They also interviewed McDonald (or McDonnell), the person who actually received the initial lump sum cash payment of $109,940, which was included in the $114,000 item) from petitioner in 1943. If the Government agents did track down this item they suppressed this important evidence.

** A photostat of the account was filed with the Clerk of this Court November 15, 1953.

item. R. E. McDonald (also referred to as McDonnell—obviously a reporter's error) was the man who actually handled the $114,000 item (R. 307). He testified that $102,700 in cash came from petitioner in July 1943 (R. 307-8, R. 324). But the agents made practically no effort to track down the part of the transaction favorable to the petitioner—namely the existence of this fund or cache as an asset at the beginning of the prosecution period.

The examining agents knew about this item of $114,000 and talked to petitioner about it (R. 263). Agent Rice testified as follows (R. 287-289):

> Q. You didn't give credit for the $114,000.00 merchandise not reflected in the books of the North Idaho Sales Company that were purchased in the year 1943?
> A. I understood that was sold.
> Q. During what year?
> A. 1943.
> Q. You just understood that?
> A. Yes, sir.
> Q. You didn't give him credit for that merchandise I take it, at the end of 1943?
> A. In talking to Mr. McFee in Mr. Emasio's office relative to these items he said that would probably be accounted for on the Foresters Club books; they related to the purchase of whiskey and liquor. There was 5 to 7 loads that we had evidence of, coming from the east, in talking to him he explained that was turnover.
> Mr. Emigh: I think that is not responsive to the question.
> The Court: I think it is, it may stand.
> A. —therefore, why should I give him credit for 113 or $114,000.00 when it was turnover. He purchased one load and then he sells that and purchases another load and takes that and sells it.
> Q. Wasn't that item of $114,000.00 a single item?
> A. No, it was evidenced by purchases.
> Q. In 1943?
> A. That is right, some of it cash, most of it, in fact all of it. It was paid in the East, St. Paul and Duluth.
> Q. What did you have at the end of 1942?
> A. Investment in the North Idaho Sales Company.

Q. Were the assets of the North Idaho Sales Company augmented by $114,000.00 in 1943?
A. Not by my computation, I followed the books.
Q. They did not show this item?
A. For liquor sales, $114,000.00 for liquor sales.
Q. As expended?
A. No.
Q. $114,000.00 didn't show on the North Idaho Sales account as expended?
A. That is right, it was paid in cash.
Q. Paid in cash?
A. That is right.

There was nothing more than an indifferent attempt to track down this important item. The agent merely let it go because he said that petitioner said it was a "turnover,"* and because it didn't show on the North Idaho Sales Company records. He could easily have confirmed the actual facts from McDonald. He knew that McDonald knew about the transaction because the Government itself called McDonald as its own witness to prove the source of the payment of the fines growing out of the transaction. But because their own investigation was inconclusive they arbitrarily resolved the issue against the petitioner and deliberately excluded the item from their opening net worth statement.

The origin of this fund is of no particular moment because it was known to exist in 1943 and $86,528.59 thereof was on hand at the beginning of 1945. Suffice it to say, at this point, that a thorough investigation would have disclosed the existence of at least $75,000 thereof as a pre-1936 account receivable and the availability of $86,528.59 thereof on January 1, 1945.

In this case, as distinguished from *Holland* v. *United States, supra,* and the three other net worth cases referred

* It is extremely unlikely that petitioner actually said it was a "turnover." The account itself, a photostat of which is on file in the Clerk's Office confirms McDonald's statement (R. 324) that it was a lump sum cash transaction. It shows an opening lump sum cash payment of $109,940.

to therein decided the same day, the claim of a cache is highly probable. The photostatic copy of the account, on file in the Office of the Clerk of this Court, follows the entire transaction from its inception in 1943, shows the disposition of each item, and demonstrates that at the beginning of the prosecution period this source alone provided an available source of cash in the amount of $86,528.59. (See Affidavit of John N. Newland, C.P.A., attached to Supplement to Petition for Writ of Certiorari filed November 15, 1953).

Regardless of what may be said as to the legal availability of the record of this account at this stage of the proceeding it demonstrates beyond reasonable doubt that the opening net worth statement used by the Government in this case omitted an item of $86,528.59 in cash or equivalent which, if included, would have completely exonerated petitioner for the year 1945. There were other errors referred to in the Newland affidavit which, together with the subsequent revision (downward) of taxable income, made by the Government in its determination of the civil tax liability, would have exonerated the petitioner of criminal liability for the year 1946 also.

This may be "looking backwards." But it demonstrates that the use of the net worth method is "so fraught with danger for the innocent that the courts must scrutinize its use." And it shows also that if the Government agents had properly investigated the case, and if the burden of proof had been clearly met by the Government, and not shifted to the petitioner, the petitioner probably would not have been convicted. We respectfully submit that this is the kind of a case where the petitioner ought to have the opportunity of a new trial conducted under the guidance of the standards set forth by this Court in *Holland* v. *United States, supra.*

3. The Investigation Upon Which the Net Worth Computation Was Based Was Wholly Inadequate.

Petitioner is an older person who had been in business on a substantial scale for many years prior to 1936 in locations other than the State of Idaho.

The Government's witness, McCain, testified that he had known petitioner for 20 or 25 years and that petitioner had been a resident of the State of Washington during the later 1920's (R. 151-152). Government witness Masterson testified that he had been employed by petitioner at Spokane, Washington, for about five years which included the year 1929 (R. 199-200).

Petitioner's witness, Grosscirth, testified that between 1929 and 1932 petitioner transacted about $100,000 worth of business with him which was paid mostly in cash (R. 399-403).

Government agent Rice testified that he had heard that petitioner had been in business for some 15 or 20 years prior to 1936 *but that he did not investigate that because it "was hearsay"* (R. 281). Government agent Olsen on the other hand testified that, in arriving at petitioner's net worth he relied upon "any hearsay evidence that we could find that would establish that he might have had assets at the beginning of the year" (R. 252).

The record is completely devoid of evidence of any effort whatever to obtain, or to present any information bearing upon, petitioner's financial history prior to 1936. Such an investigation would have disclosed that such prior business operations were substantial, that they involved large sums of money and that they provided a source of at least $75,000 in accounts receivable in the nature of a return of capital, which were collected shortly prior to the prosecution period and which formed a large part of the $114,000 item for 1943 known to the Government agents but not included in the opening net worth computation.

The real investigation for the purpose of the net worth computation began with a search of records beginning with

the year 1942 and continuing forward to the year 1947 (R. 281-282). The agents searched county and court records in six locations in Northern Idaho (R. 239). But they were not looking for assets on hand. They did not attempt to ascertain whether petitioner owned various pieces of property in Shoshone County or other Northern Idaho counties (R. 281-282). They were looking only for records of sales of property (R. 282). They found no undisclosed or secret bank accounts. They found only one personal bank account concerning which there was no secrecy. But they overlooked two bank accounts, closed out shortly prior to the prosecution period, and other recorded assets, totalling $32,484.33, which (in addition to the $86,528.59 derived from the $114,000 item) were not included in the opening net worth computation (see affidavit of John N. Newland attached to Supplement to Petition for Writ of Certiorari, filed herein Nov. 15, 1953). Furthermore they made no effort to inquire as to whether petitioner had any bank accounts in Spokane (R. 281) a place of former business operations (R. 153, 200).

Agent Rice said he made no investigation of any brokerage houses, for stocks or bonds or other assets (R. 283) and the testimony of Agent Olsen (who said he had testified as to his entire search for assets) is devoid of any reference to an investigation of brokerage houses or brokerage accounts. Petitioner claimed that he had made extensive investments in stocks purchased through stock brokers in 1927 and 1928 (R. 372). There is no doubt but that petitioner had a penchant for investing in stocks—particularly mining stocks (R. 219; 140-141; 166). Even the opening net worth statement shows investment of $20,603 in mining and other stocks (Appendix p. 25, post). Proceeds of sales of stocks prior to 1945 could well have provided a substantial additional source of funds for petitioner's 1945 and 1946 expenditures.

The Government agents examined petitioner's partnership books of account for the years 1942-1947 but did not

have, nor did they examine, any of his books and records for the period 1936-1941 or prior thereto (R. 275). They did not examine any of his individual books of account at all (R. 286).* For the period 1936-1941 the agents did not have or know petitioner's annual or total gross income. The Tax returns for those years had been destroyed (R. 50). They had only petitioner's annual *net* income (R. 284) and the amounts of taxes paid. Net income obviously would not disclose the untaxed portion of capital gains, or untaxed income offset by depreciation, all of which would provide a source of funds in excess of taxable net income.

There is no doubt but that petitioner habitually kept a considerable amount of cash on hand. Ruth Poska approximated the amount as being in excess of $50,000 in 1945 (R. 395) and testified that she had so informed the investigating agents when questioned on the point (R. 395).

Nevertheless, in making up their opening net worth statement for the prosecution period petitioner was given no credit whatever for any cash on hand (see App. p. 25, post). The Government agent testified that they made their net worth computation from such information as they had available (R. 285). But it must be evident that they were highly selective and apparently chose to ignore considerable information favorable to the taxpayer.

In an effort to establish a firm starting point for the opening net worth computation the Government produced evidence (1) that petitioner was employed in the meat department of a grocery store for 8 or 10 months in 1935 at $50 or $60 a week with a 25% bonus on any earnings (R. 152), (2) that pteitioner made an initial investment of less than $2,000 in the North Idaho Sales Company in 1936 (R. 190), and (3) that in 1936 he lived frugally with an employee in a cinder-block building owned by petitioner, that they did their own cooking and that petitioner at

* Helen Knoerr who kept these accounts showing the $114,000 item was not in petitioner's employ when the investigation was made. These accounts were merely piled in an old storeroom together with other old records.

times did not have enough money in bank to honor the checks issued to his employee for wages (R 203). But the record did not show that petitioner was then sending his daughter to college.

From 1936 to 1942 the record is silent as to petitioner's financial affairs except as to his annual taxable net income, and his capital account and other assets shown on the books of the North Idaho Sales Company *beginning with 1942.*

The poor financial condition, or rather poor cash position, of petitioner in 1936 was, of course, a circumstance tending to show the lack of available cash funds in 1936. But that period was relatively remote. It was 9 years prior to the prosecution period. There was no proof, with respect to the intervening period, that petitioner was in dire financial straits or that he was not in possession of substantial assets prior to the prosecution period. On the contrary the Government agent Olsen testified that according to his figures petitioner's net worth at the beginning of the prosecution period was $185,325.50 (R. 246). And he admitted that this did not include the item of $114,000, known to exist in 1943 (R. 263, R. 288). Somewhere, in between 1936 and January 1, 1945 petitioner accumulated a total of net assets in excess of at least $290,000 ($185,300 plus $109,940 which latter figure is the exact amount of the original lump sum cash payment in 1943 as shown by the transcript of account filed herein on November 15, 1953, which amount is included in the $114,000 figure referred to by the Government agent Rice (R. 307)).

It is just as logical to infer (if we must infer guilt from the possession of assets which an investigating revenue agent is unable to account for) that this figure of $109,940 constituted unreported income for the year 1943, or for some prior years, as it is to assume that petitioner did not have a substantial portion thereof at the beginning of 1945, and hence to infer petitioner's guilt for 1945.

In *Holland* v. *United States, supra,* the evidence relied upon by the Government to corroborate the non-existence

of prior assets completely accounted for an area of several states and thoroughly went back over a score of years prior to the prosecution period, thus effectively refuting the existence of a cache. In the present case, on the other hand, although petitioner had been in business for many years prior to 1936 in several states, the investigation did not cover any of petitioner's activities prior to 1936. Furthermore there is a hiatus between 1936 and 1942, and the search beginning with 1942 included only six locations in Idaho, and that search was directed to *sales* and not to assets of record (R. 282). Moreover in *Holland* v. *United States, supra,* a probable and available source of unreported current income was shown, whereas, in the present case a probable source of current unreported income was not shown.

In *Friedberg* v. *United States* (No. 18) also decided December 6, 1954, by this Court, the taxpayer's finances were traced from as far back as the year 1922, and the evidence pointed unmistakably to the conclusion that there was no hoard of cash at the beginning of the prosecution period.

In *Smith* v. *United States* (No. 52) also decided by this Court on December 6, 1954, the evidence showed no tax returns filed for 1936 through 1939, non-taxable or non-assessable returns were filed for the years 1940 through 1944, with a taxable return for the year 1941; also that from 1941-1945 the taxpayer worked for $40 a week and that his wife worked also. Such evidence covered the period immediately prior to the prosecution period and strongly negatived the existence of a cache available for the mink coat, brokerage accounts, 9 new bank accounts and other assets acquired during the prosecution period.

In *United States* v. *Calderon* (No. 25) also decided by this Court on December 6, 1954, there was not sufficient evidence of the taxpayer's prior financial history to substantiate the net worth statement used therein. But the Court pointed out that the taxpayer himself testified that his cash on hand at the beginning was not sufficient to

account for his net worth increase even for the first year of the prosecution period.

In all of the above cases, the existence of a pre-prosecution period fund or source adequate to account for the alleged net worth increase was negatived by the evidence adduced in the case. In the present case the evidence not only indicated the strong probability of such a fund, but the exact amount thereof is shown by the account on file in the office of the Clerk of this Court, and by the affidavit of John N. Newland attached to the Motion for leave to file Supplement to Petition for Writ of Certiorari filed November 15, 1953, herein.

Such fund was adequate to completely exonerate petitioner for the year 1945. The alleged net income for 1945 based on the alleged net worth increase was $105,077.90 (R. 243). Petitioner reported a net income of $25,166.67 (R. 243) leaving a balance of $79,911.23 alleged to be unreported. Petitioner had on hand $86,528.59 or $6,617.37 more than necessary to account for the entire alleged net worth increase for 1945.

As for 1946, the alleged unreported income was $70,769.76 (R. 245). As shown by the Newland affidavit referred to above the Government agents understated physical assets on hand to the extent of at least $32,484.33 in addition to the $86,528.59 available from the $114,000 item. Thus the net worth statement for 1946 is in error to the extent of at least $39,101.99 ($6,617.37 plus $32,484.33). In addition to the above, the Government conceded an error of $39,000 in income in its determination of civil tax liability for the year 1946. Thus there is a reasonable probability that petitioner actually owed no additional tax whatever (in excess of that paid on the $39,679.01 of income reported in his 1946 return).

4. Petitioner's Books of Account Were Complete and Accurate, and Accounted for All of His Alleged Net Worth Increase for 1945 and for All of His Probable Net Worth Increase for 1946.

Petitioner's books of account were kept by employees. All cash receipts were received by employees and recorded either on the cash registers, in the case of the taverns (R. 301, 325, 361) or in the collection books in the case of the coin operated machines. Location owners where the coin operated machines were located received one-half of the proceeds, signed a receipt and received a duplicate copy. All cash was balanced daily with the collection books (or cash registers) by employees, and deposited in bank by employees. (R. 205-209; 297; 327; 335; 347; 357; 360; 367) These record were again balanced monthly by employees and were sent monthly to an independent accountant who audited the accounts, checked them against bank deposits, and maintained a ledger reflecting the entire operation. (R. 80). The examining agents did not have the books for the period 1936-1941 (R. 275) but presumably the books beginning with the year 1942 carried over, accurately, the account balances existing at the end of 1941, although they would not reflect distributions made to petitioner prior to 1942. At any rate the Government agents accepted them as being correct in reflecting amounts available to petitioner from that source from and after the beginning of 1942 (R. 288).

In addition to petitioner's business books of account petitioner kept a personal account of that portion of his cash on hand and the disposition thereof, which was included in the $114,000 item referred to above and which is shown in the 73 page account filed November 15, 1953 with the Clerk of this Court. This was not an income account. All earnings from the assets reflected in this account, were duly recorded and reported in his business books of account (R. 370). And as stated by the Government witness Olsen there is no requirement in the case of individuals (as distinguished from corporations) that the taxpayer

maintain, or show in his return, any financial statement of assets, other than taxable receipts and disbursements (R. 254).

There is no evidence in this case that petitioner's books of account were not full and complete and accurate—except the inference that might be drawn from the alleged net worth increases, and the testimony of the examining agent that he was unable to find out where the "unexplained" increases came from (R. 242). But that inference is negatived by the agent's admission that the "unexplained" increases might have come from prior cash on hand (R. 253) and by the wholly inadequate investigation of petitioner's past financial history, and of the $114,000 item.

So we have, in this case, a situation where books of account which appear correct on their face are, by inference based upon a net worth statement, assumed to be incomplete or incorrect. Then a further inference is tacked onto the first inference namely, that since the source of the "unexplained" increase is unknown, and even though no probable source thereof is shown, the amount is assumed to be taxable income.

Then there is a third inference based on the other two, namely, that since the books of account were inferred to be incorrect, and inasmuch as the "unexplained" and unreported increase was inferred to be income, the petitioner's failure to report such amount was willful, and therefore he was guilty.

It is respectfully submitted that such multiple inferences are not justified in this case; and that the circumstances surrounding the alleged net worth increase are as consistent with innocence as with willful violation, and that there is here a strong probability of a miscarriage of justice because of the use of the net worth method, without regard to the proper safeguards referred to by this Court in *Holland* v. *United States, supra.*

5. Petitioner Was Called Upon Not Only to Explain the Alleged Bulge in His Net Worth, But Also to Demonstrate That He Had Received No Unreported Income From the Suspected Source.

As has been pointed out above the Government's case was premised upon an alleged "bulge" in net worth from admittedly unknown sources (R. 242), without proof of the receipt, or of the opportunity of receipt, of any unreported income from any known source. It is quite clear however, from the testimony of the government witness Masterson (R. 199), and from the cross examination of petitioner's witnesses, and from the Court's charge to the jury, that the government's theory of the case was that petitioner had somehow obtained the unexplained funds from current collections made from the coin operated machines (R. 408, 397, 352, 384, 330, 338-344, 346, 351-352, 353). But there was no evidence tending to support such a theory. Government witness, Masterson, one of the collectors, testified that petitioner did not get any of the collections from any location (R. 208-210). The evidence, which petitioner was forced to produce following the denial of his motion for judgment of acquittal at the close of the government's case (R. 28) affirmatively shows that petitioner had no access whatever to that source. The machines were locked and petitioner did not have a key; petitioner made no collections himself; all collections were made by an employee in the presence of the owner of the location; the owner of the location received one-half of the collection; and received a copy of the collection slip which was made out in triplicate; and the amount of the collection was checked and rechecked, deposited in bank, reconciled and balanced with the collection slips and recorded on the books of account (R. 296, 297, 303, 327, 328, 335, 336, 348, 350, 355-357, 358, 361, 367, 398). All this was done by employees. The collection slips were contained in triplicate in books. The collector kept one copy, the

location owner received one copy and the third copy was kept for bookkeeping purposes and for checking against the cash, or against the bank deposit slips turned in by the collector (R. 205).

The truth of the matter probably is that the government suspected that petitioner in some unknown manner had connived with some of the location owners to split a portion of the coin box receipts prior to recordation (R. 344). That, undoubtedly, accounts for the continued effort, on cross examination by the Government, to find out exact locations of these machines so they could interrogate the location owners. But there is not a word of evidence direct or indirect, upon which such an inference could possibly be predicated.

The trial Court, however, caught the spirit of the thing and concluded that if the petitioner had produced all of the collection books or slips used during the two year prosecution period, and had totalled them all up and had checked them against the books, that would have established that petitioner's witnesses had told the truth and would have exonerated the defendant. So he commented to the jury as follows (R. 417):

> "I don't want to comment on the evidence but there is one outstanding matter that you are left in the dark about, I don't intend to make any inference about it, as the evidence here is solely for you. But where are the tickets that should show the receipts and division of the money taken from the slot machines for the years 1945 and 1946. There was only one of these books of tickets introduced in evidence by the defense. None of the witnesses, bookkeeper, manager or other witnesses for the defense produced these tickets and all said they had no knowledge of these tickets. The tickets were traced to the possession of defendant McFee. It seems to the Court that if the tickets balanced with the bank account that it would have been an easy matter for the defense to produce the tickets if they had not been destroyed. Why were

they not produced to show the receipts of the slot machines for these years?

"The burden of proof resting upon the Government does not shift during the case but when in the trial of charges of income tax evasion discrepancies between the taxpayer's returns and his actual income are indicated by the Government's proof, the failure of the defendant to offer explanation in any form may be considered by you in finding your verdict."

This comment was objected to (R. 424); and the Court then told the jury not to be influenced by the Court's remarks as to what the Court thought about petitioner's failure to produce the collection slips, but still left the jury with the thought that this was a very important point for their consideration (R. 424).

The effect of the Court's remarks was to shift to the petitioner the burden of establishing beyond a reasonable doubt that the coin box collections were not even a possible source of the alleged net worth "bulge." This was particularly onerous because the likelihood or even the possibility of such a source, had not been established by the government by any evidence of any kind direct or indirect. Petitioner was called upon to conclusively rebut a mere suspicion.

Moreover the collection slips, or books were mere temporary records, of a type which normally would not be preserved by petitioner or by any other business concern over a period of years. These records were voluminous. Three or four books were used by one collector each week and there were several collectors—as many as eight (R. 204). They had been checked, and double checked and entered and balanced in the permanent books of account (R. 398). It is not common business practice to preserve such preliminary or temporary records.

Furthermore since these temporary records were currently turned over to petitioner, the court's charge in

effect required the petitioner, himself, to take the witness stand to account for these records or at his peril to submit to an adverse inference by the jury.

The danger of requiring the taxpayer to assume such a burden of proof was specifically referred to in *Holland* v. *United States, supra,* whereas the lawful burden of proof to establish every element of the offense was on the government (see pages 5 and 16 of printed opinion in *Holland* v. *United States, supra*).

We submit that it was not incumbent upon petitioner to rebut a mere suspicion, and that the comment of the Court was unwarranted and highly prejudicial.

CONCLUSION

As pointed out by this Court in *Holland* v. *United States, supra,* the use of the net worth method "is so fraught with danger for the innocent that the courts must closely scrutinize its use." In the present case, as distinguished from *Holland* v. *United States, supra,* (a) the Government did not establish a likely source of the alleged net worth increase; (b) the Government agents failed to track down an important and relevant lead as to the existence of a substantial asset referred to as an item of $114,000; (c) the investigation upon which the opening net worth computation was based was wholly inadequate, not only as to the period immediately preceding the prosecution period, but also as to petitioner's financial history prior to 1936; (d) petitioner's books of account were complete and accurate and accounted for his entire alleged net increase for the year 1945 and accounted for the amount of net increase subsequently determined in his civil tax liability for 1946; and (e) petitioner was called upon to assume the burden of proof to refute, beyond a reasonable doubt, the suspected, but not proved, source of alleged unreported income.

We submit that these things are the kind referred to in *Holland* v. *United States,* that the courts should guard against, and that this is the kind of case where the petitioner ought to have the opportunity of a new trial conducted under the guidance of the standards set forth by this Court in *Holland* v. *United States, supra.*

Wherefore petitioner prays that his Petition for Writ of Certiorari be granted.

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A. E. McFee
Net Worth Statements - Showing the Changes during the Years 1945
1945 in the Properties Owned.

YEAR 1945

Assets	Position Last of Jan 1st 1945	Position last of Dec 31st 1945	Changes during Year Increase	Changes during Year (Net) (Decrease)
Checking Account - Special Account - First National Bank - Wallace	160172	591219	431047	None
Stocks Owned - Mining and other	2060360	2720360	660000	None
Real Estate - Rental Property	3235000	4145000	910000	None
Government Bonds	677500	1677500	1000000	None
Loans Receivable	250000	461306	436306	None
Cashiers Checks	2290000	2290000	None	None
Dan Murphy Lease - Total Net Investment	1723427	2891195	1177766	None
Dan Mfee Lease - Investment Account	None	167749	167749	None
Forresters Club - Crescent Lease - Investment Account	1835899	252232	None	(163667)
Forresters Club - Crescent Lease Contract	None	1000000	1000000	None
Forresters Club - Division - Investment Account	945416	2085052	1149636	None
Elks Club - Wallace - Investment Account	968829	877133	None	(91696)
Miscellaneous Receivable	112667	306171	193504	None
Cash from Checks - Forresters Club Division Clearing	None	1500000	1500000	None
Cash from Sandwich Repayment of Loans	None	100000	100000	None
North Idaho Sales Company - Investment Account	5769377	6266103	496726	None
Total Assets	20276713	31015620	12941734	(222827)
Liabilities and Reserves				
Notes Payable - Idaho First National Bank - Not On Both / North Idaho Sales Co	1670000	1661087	None	(8913)
Reserve for Depreciation - Rental Property Allowed on Returns	94163	241013	146850	None
Total Liabilities and Reserves	1764163	1902100	146850	(8913)
Total Net Worth	18512550	29113520	12794884	(213914)
Changes during Year Net Increase			12794884	
Changes during Year Net Decrease			(213914)	
Increase in Net Worth during the Year 1945				18510970

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Year 1946

A F McFee
Net Worth Statements – Showing the Changes During the Year 1946 in the Property

Assets	Assets on Hand As of Jan 1st 1946	Assets on Hand as of Dec 31st 1946	Changes During Year Increase	Changes During Year (Net) (Decrease)
Checking Account - Special Account - First National Bank - Wallace	4912.19	2772.40	None	(2139.79)
Stocks Owned – Mining and Other	270360	425560	155200	None
REAL Estate – Rental Property	415000	415000	None	None
Government Bonds	1697500	1697500	None	None
Loans Receivable	421306	510306	490000	None
Cashiers Checks	2290000	2390000	1100000	None
Dan Murphy Lease – Total Net Investment	2831795	1615577	None	(1232618)
Dan Mac Lease - Investment Account	169779	(165166)	None	(329915)
Foresters Club - Coeur d Alene - Investment Account	252232	252232	None	None
Foresters Club - Coeur d Alene - Contract	1000000	1000000	None	None
Elem Club - Athol Investment	377133	377133	None	None
Samuels Hotel - Investment	None	2728322	2728322	None
Miscellaneous Receivables	306171	None	None	(306171)
Cash From Check - Foresters Club - Lewiston	150000	None	None	(150000)
Cash From Sandack Repayment	100000	None	None	(100000)
Foresters Club Lewiston - Investment	2075032	3432235	1337178	None
North Idaho Sales Co. Investment Account	626603	1863474	1236871	None
Total Assets	3101562	3827519	11584576	(3731619)
Less				
Liabilities & Reserves				
Notes Payable – Idaho First National Bank Not Shown on Books / North Idaho Sales	461087	107719	None	(563768)
Reserve for Depreciation - Rental Property Allowed on Returns	241063	421513	180500	
Total Liabilities & Reserves	1702150	1512382	180500	(563768)
total Net Worth	2911350	3738681	11378076	(3167915)
Changes During year – Net Increases			11378076	
Changes During year - Net Decreases			(3167915)	
Increase in Net Worth During the year 1945				8210161